

Message Text

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ACTION EUR-25

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INFO AMMBASSY BONN 1850

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AMEMBASSY THE HAGUE

AMEMBASSY ROME

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PASS TREASURY AND FEDERAL RESERVE

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TAGS: ECON, EFIN, ENRG, FR

SUBJECT: OIL PRICE/ SUPPLY EFFECTS ON ECONOMIC OUTLOOK

REF: PARIS OECD 32661

1. SUMMARY. EMBASSY DISCUSSED ECONOMIC OUTLOOK IN LIGHT OF OIL PRICE/SUPPLY SITUATION WITH YVES BERNARD, CHIEF UNIFIED FORECAST DIVISION, FRENCH TREASURY. BERNARD TALKED ABOUT POSSIBLE EFFECTS OF VARYING SUPPLY SHORTFALLS, BUT SAID CURRENT REVISED GOF FORECASTING BASED ON EFFECT OF PRICE ONLY. CONCLUDED IN 1974 REAL GROWTH WOULD FALL TO 4.0 PERCENT, AND UNEMPLOYMENT WOULD INCREASE. GOODS LIMITED OFFICIAL USE

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AND SERVICES BALANCE WOULD DETERIORATE FROM SURPLUS OF F. 8

BILLION TO A DEFICIT OF ABOUT F. 17 BILLION. GOF DID NOT HAVE
PRECISE INFLATION FORECAST BUT HOPES UNCERTAIN EMPLOYMENT WILL
LEAD UNIONS TO MODERATE WAGE DEMANDS. OTHERWISE ALREADY SEVERE
INFLATION WILL BECOME INTENSE. END SUMMARY.

2. ASKED ABOUT ECONOMIC EFFECTS OF VARYING OIL SUPPLY
SHORTFALLS, BERNARD GAVE FURTHER DESCRIPTION OF CALCULATION THAT
(REFTEL) IN 1974 FRANCE COULD ABSORB UP TO 10 PERCENT REDUCTION
FROM 1973 SUPPLY OR 20 PERCENT FROM EXPECTED 1974 NEEDS WITHOUT
SUBSTANTIAL OVERALL INDUSTRIAL EFFECTS. THIS ASSUMES POSITIVE
BUT SMALL INDUSTRIAL SUBSTITUTION AND ECONOMIZING EFFECTS,
POSITIVE BUT SMALL DRAWDOWN ON STOCKS (ESTIMATED AT 3 MONTHS
CONSUMPTION) AND SEVERE ECONOMIES OF 20 PERCENT IN HEATING FUEL
AND 35 PERCENT IN AUTO FUEL. BEYOND 10 PERCENT REDUCTION INDUSTRIAL
EFFECTS WOULD BE INCREASINGLY SEVERE, WITH 15 PERCENT
REDUCTION AS EXAMPLE POSSIBLE LEADING TO 4 PERCENT DROP IN
NATIONAL PRODUCT FROM 55 PERCENT TO 1.5 PERCENT. THIS STUDY BASED
ON OCTOBER PRICES, HOWEVER. BERNARD NOTED THAT ELASTICITIES
INVOLVED IN THESE CALCULATIONS WERE DIFFICULT TO ESTIMATE.

3. OUTLOOK CHANGED WITH DECEMBER PRICE/SUPPLY ANNOUNCEMENT.
WITH SUPPLY RESTRICTION SCENARIO LESS LIKELY AND PRELIMINARY
STUDY OF EFFECTS ALREADY DONE, GOF ECONOMISTS NOW GEARED TO FORE-
CASE SOLELY ON BASIS OF EFFECTS OF PRESENT PRICES RATHER THAN SUPPLY
RESTRICTIONS. CONSUMPTION RESTRAINT WOULD REMAIN IN
PICTURE HOWEVER AS IMPORTING COUNTRIES WOULD HAVE TO RESTRAIN
CONSUMPTION TO REDUCE HORRENDOUS BALANCE OF PAYMENTS COSTS.
VARIABLES FORECAST BELOW ARE BASED ON THESE ASSUMPTIONS.

4. ECONOMIC GROWTH. PRESENT FORECASE REDUCED PREVIOUSLY
EXPECTED 5.5 PERCENT REAL GROWTH IN 1974 TO 4.0 OR 4.5 PERCENT
AS A RESULT OF PRICE EFFECTS AND RESTRICTIONS ON PETROLEUM USE AND
RESULTANT EFFECTS IN CERTAIN INDUSTRIES. BERNARD DENIED
ANY KNOWLEDGE OF REPORT IN LE MONDE THAT REPUTED GOVERNMENT
FORECAST SHOWED FRENCH GROWTH WOULD BE REDUCED TO 2 TO 2.5 PER
CENT IF GROWTH IN REST OF EUROPE DROPPED TO ZERO.

5. TRADE AND PAYMENTS. OBVIOUSLY EFFECTS WOULD BE SEVERE.
PETROLEUM IN 1973 FORMED 13 PERCENT OF VALUE OF ALL FRENCH
IMPORTS. NOW ITS CIF PRICE WOULD INCREASE FROM F110/TON
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TO OVER F300/TON. BERNARD CONFIRMED THE BASIC ARITHMETIC OF
THE ESTIMATED 30 BILLION FRANC INCREASE IN THE IMPORT BILL
CITED BY FINANCE MINISTER GISCARD D'ESTAING (REFTEL) NOTING THAT
THIS INCLUDED A PREVIOUSLY EXPECTED 10 PERCENT INCREASE IN
IMPORTS (FROM 128 TO 140 MILLION TONS). THE MINISTER HAD
EXPLAINED THAT, WITH A 10 PERCENT CUTBACK FROM EXPECTED CONSUMPTION,
THE POSTIVE GOODS AND SERVICES BALANCE OF 8 BILLION FRANCS
WOULD BE REDUCED TO A 18 BILLION FRANC DEFICIT IN 1974.

BERNARD GAVE A LOWER FIGURE OF 16.6 BILLION FRANCS, BUT NOTED THAT PERSONALLY HE ESTIMATED THAT CURRENT RESTRICTIONS PLUS PRICE EFFECTS WOULD YIELD NO MORE THAN A 10 MILLION TON REDUCTION IN IMPORTS IN 1974, FROM 140 TO 130 MILLION TONS, RATHER THAN THE LARGER 10 PERCENT REDUCTION CITED BY THE FINANCE MINISTER. AS A RESULT FRANCE WOULD HAVE TO LOOK FOR WAYS TO IMPROVE ITS PAYMENTS POSITION. IMPROVEMENT RELATIVE TO THE REST OF ESTERN EUROPE WAS NOT A SOLUTION AS ALL THESE COUNTRIES WERE IN THE SAME BOAT; PRICE INCREASES HAD FALLEN ON EVERONE EQUALLY. FRANCE WOULD, HOWEVER, KEEP SHARE OF MARKET IT HAD GAINED IN LAST YEARS. EASTERN EUROPE DID OFFER POSSIBILITIES, HOWEVER, EXPORTS COULD GO UP SUBSTANTIALLY TO OIL PRODUCING LDCS THAT COULD ABSORB THEM, LIKE ALGERIA AND IRAN BUT NOT TO THE PERSIAN GULF STATES. EXPORTS TO OTHER LDCS MIGHT WELL SUFFER. OVERALL, THE GROWTH IN VOLUME OF BOTH EXPORTS AND IMPORTS WOULD DECELERATE, AT ABOUT SAME RATE FOR EACH.

6. WAGES AND PRICES. GOF HAS NOT ARRIVED AT DEFINITE PRICE FORECAST AS THEY CONSIDER THAT PRICE PERFORMANCE WILL DEPEND ON WAGE SETTLEMENTS. THEY HOPE WAGE GROWTH WILL MODERATE IN 1974 AS UNIONS BECOME MORE CONCERNED ABOUT PRESERVING EMPLOYMENT. IN ANY CASE POSSIBLE INCREASE IN PURCHAING POWER IS LIMITED. WHILE OVER 5 PERCENT IN 1973, EARLIER FORECAST SHOWED PURCHASING POWER GROWING 4.8 PERCENT IN 1974. WITH THE MOST RECENT OIL PRICE SETTLEMENT, POSSIBLE INCREASES IN PURCHASING POWER NOW ESTIMATED AT 1 TO 2 PERCENT LESS. ANY WAGE INCREASES BEYOND THIS WOULD SIMPLY ADD TO INFLATION. BERNARD SAID THAT MECHANICAL EFFECT OF OIL PRICE INCREASE (1.5 TO 2.0 PERCENT) WAS NOT NECESSARILY ADDITIVE TO PREVIOUS INFLATION FORECAST (AT LEAST 10 PERCENT) AS IT MIGHT GENERATE MODERATION IN OTHER SECTORS.

7. EMPLOYMENT. THE REVISED LOWER RATE OF ECONOMIC GROWTH
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IMPLIED THAT UNEMPLOYMENT WOULD INCRESE. FRANCE WOULD NEED A 2 PERCENT INCREASE IN JOBS IN 1974 TO ABSORB A GROWING LABOR FORCE. A 4 PERCENT RATE OF GROWTH WOULD ONLY GENERATE 1 PERCENT MORE JOBS UNDER THESE ASSUMPTIONS, THE PRESENT ESTIMATE OF 500,000 UNEMPLOYED COULD GROW BY 140,000, ALTHOUGH BERNARD NOTED THAT SOME INCLUDED IN THIS FIGURE WOULD PROBABLY DROP OUT OF JOB MARKET. EVEN A DROP IN AVERAGE WEEKLY HOURS WORKED BEYOND THE PRESENT TREND DECREASE OF 0.9 PERCENT PER YEAR COULD NOT ENTIRELY COMPENSATE FOR THIS SOFTENING OF THE LABOR MARKET.

8. ASKED ABOUT THE SITUAION OF IMMIGRANT WORKERS, BERNARD RESPONDED THAT IT DEPENDED ON WHETHER SECTORS WHERE THEY WERE PREVALENT WERE AFFECTED. BUILDING AND PUBLIC WORKS WAS PARTICULARLY IMPORTANT FOR EXAMPLE AND THE OUTLOOK IN THIS

SECTOR DEPENDED ON WHETHER THE GOF WOULD HAVE TO CHANGE ITS
POLICIES FOR MACROECONOMIC# REASONS.

9. BARNARD ALSO GAVE US AN INTERNAL GOF DOCUMENT SHOWING
DETAILED INDUSTRY CONSUMPTION OF HEAVY FUEL OIL AND ITS RELATIVE
IMPORTANCE IN THE PRODUCTION OF DIFFERENT GOODS. WILL POUCH
SEPARATELY BY AIRGRAM.
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